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INTERNATIONAL COOPERATION AND INTERNATIONAL RELATIONS

THE POLICY OF REGIONAL CONVERGENCE IN RUSSIA — BELARUS INTEGRATION: PROSPECTS FOR DEVELOPMENT

V. G. Chaplygin[*]

In a number of cases, integration of a large international region or an interstate union can only be promoted by political means. The policy of regional economic convergence prevails in many sectors. The single economic market and membership in economic and monetary unions give a new impetus to consolidation. The study aims to identify and explore the problems of political governance, which the Union State of Russia-Belarus faces due to their asymmetric and not completely compatible economies. The author analyzes the process of interstate convergence, considering it as an essential part of integration and explores a number of specific characteristics underlying the Russian — Belarusian economic integration. The author offers a set of criteria of convergence/not convergence of the states, describes the principles of their economic and political rapprochement and offers models of convergence as well as prerequisites for them. The article examines the principles that determine the participation of a country in international integration as well as prospects for the further development of the regional economic and political mechanisms, which are being formed now. Based on the given economic indicators, the author gives a forecast for the development of the union state.

***Key words**:* interstate regional convergence, political cooperation, the theory of additivity, geographic diversification, foreign policy, unity

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> ...The present political necessity ought to be no concern of the economic scientist. His task ought to be, as I will not cease repeating, to make politically possible what today may be politically impossible. To decide what can be done at the moment is the task of the politician, not of the economist...
>
> *Friedrich A. Hayek*

Amid the ongoing academic discussion on the applicability of this or that model of economic and political integration, it is important to stress that each 'model' corresponds to a certain type of economic and political organisation of a state [13, 17, 18, 19, 20, 21].

Today, it is difficult to refute the positive effect of integration on the socioeconomic development of participating countries. The convergence of socioeconomic development of involved countries is a major objective for the participants of the integration process [10]. The economic relations of economic systems are determined not by their geographical proximity or remoteness but by the level of economic affinity. This thesis should be recognised as the principle of economic integration.

Additivity means that common efforts of two groups will yield the same or a better result than the one that would be achieved by separate production. It seems quite obvious that uniting never leads to weakening. However, it is not always evident, since this concept suggests that the two groups can go into production separately. The positive effects of the additivity factor are coupled with the diminishing return accounted for by the limitedness of factors.

As a rule, changes at 'deeper levels' are more complicated than those at 'surface levels'. However, the latter are sometimes impossible without the former, which is one of the reasons of institutional stability, and an obstacle to changes. These circumstances create a situation termed 'spillover effect' by Leon Lindberg. It takes place when 'a given action related to a specific goal creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and a need for more action, and so forth' [16, p. 10]. The actual political processes show that this effect does not appear on its own, but rather it requires a political incentive, which cannot always be provided by the actor.

The Russia-Belarus union aims to crate the most advanced mechanism in the CIS for the economic integration of the two states based on building a unique economic and social space. At the same time, one cannot exclude that the adjustment of the common economic mechanism can be stalled by political infighting. As is well known, at the stage when economies are given a 'boost' to satisfy the 'conformity criteria', countries have to deal with serious discrepancies in budget deficit, interest rates, etc. Thus, it is very unclear

how coordinated the actions of the Russian Federation and the Republic of Belarus will be in the conditions when all major economic leverages are delegated to supranational bodies designed to shape and implement a common economic policy. The ensuing loss of economic sovereignty — which is the point of discussion here — can become an additional source of tension.

In 2000—2012, the trade turnover of the Republic of Belarus was steadily increasing (table). Despite the 2009—2010 decrease, unprecedented results were attained in 2012 — a 5.7-fold increase over the 2000 level. As both fig. 2 and the table show, Russia accounts for most of Belarus's trade turnover. In 2015, trade with Belarus comprised 4.5 % of Russian exports (34.7 % of that to the CIS countries), Ukraine 2.7 % (20.8 % to the CIS), and Kazakhstan 3.2 % (24.2 % to the CIS). As to imports, Belarus accounted for 4.9 % (43 % of Russian imports from the CIS), Ukraine for 3.1 % (27.3 % from the CIS), and Kazakhstan for 2.7 % (23.5 % from the CIS). Note that, since 2000, the proportion of Belarus in Russia's trade with the CIS has been increasing, and that in exports decreasing, although a positive trend has been observed in the past two years.

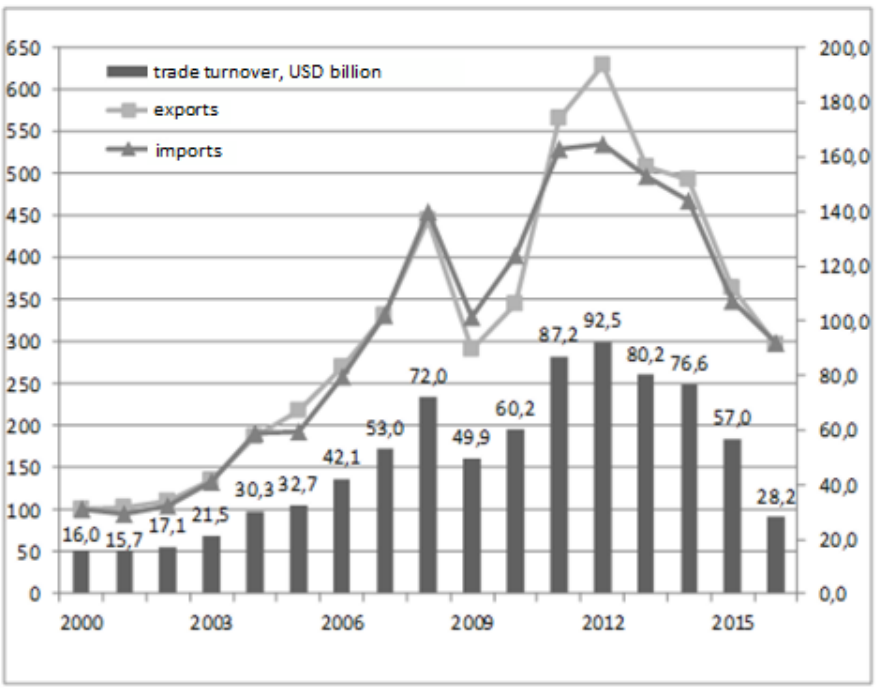

Fig. 1. Changes in the trade turnover of the Republic of Belarus, % as of 2000

Compilation based on [1; 4].

Structure of Russia's trade with the CIS countries,%

Parameter	2000	2005	2010	2011	2012	2013	2014	2015
Exports								
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Including trade with the EAEU countries	57.68	52.93	51.06	51.50	54.40	54.94	59.40	62.38
By country:								
Azerbaijan	0.98	2.63	2.62	3.15	3.59	3.98	5.27	5.11
Armenia	0.20	0.59	1.17	0.99	1.16	1.35	1.71	2.34
Belarus	40.28	31.01	30.34	31.38	31.67	27.36	32.20	34.71
Georgia	0.31	1.08	-	-	-	-	-	-
Kazakhstan	16.25	20.00	17.94	17.75	19.81	23.85	22.06	24.20
Kyrgyzstan	0.75	1.22	1.66	1.46	2.06	2.74	2.72	2.90
Moldova	1.52	1.37	1.86	1.87	2.03	1.79	2.31	2.31
Tajikistan	0.40	0.74	1.13	0.91	0.86	0.98	1.39	1.70
Turkmenistan	0.94	0.69	1.27	1.45	1.53	1.93	1.81	2.04
Uzbekistan	1.98	2.64	3.17	2.65	2.93	3.79	4.88	4.99
Ukraine	36.34	38.01	38.84	38.39	34.35	32.21	26.67	20.76
Imports								
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Including trade with the EAEU countries	53.74	48.33	47.31	47.88	53.54	51.82	78.90	67.52
By country:								
Azerbaijan	1.16	1.08	1.22	1.28	1.26	1.65	1.94	2.49
Armenia	0.38	0.53	0.50	0.47	0.67	0.91	0.96	0.95
Belarus	31.97	30.09	31.37	32.36	30.56	36.18	46.78	42.96
Georgia	0.66	0.83	-	-	-	-	-	-
Kazakhstan	18.96	16.98	14.02	14.67	22.39	15.26	22.54	23.46
Kyrgyzstan	0.76	0.77	1.24	0.65	0.44	0.29	0.22	0.34
Moldova	2.80	2.88	1.33	1.05	1.06	1.08	0.96	0.89
Tajikistan	2.04	0.50	0.67	0.20	0.15	0.10	0.11	0.25
Turkmenistan	4.08	0.41	0.47	0.32	0.41	0.36	0.28	0.35
Uzbekistan	5.71	4.76	4.91	4.14	3.10	3.26	2.67	2.89
Ukraine	31.46	41.16	44.27	44.88	39.97	40.92	32.77	27.27

Calculations based on [6].

This parameter comes useful in analysing the closeness of economic ties. However, it is important to make several reservations.

— Unilateral trade relations and narrow economic diversification pose a potential economic threat. If a crisis arises in the counteragent country, it will also affect the other state.

— If the integration agreements are fully implemented, the export potential of Belarus will decrease by the above magnitude, since this proportion of external trade turnover will be redefined as internal trade.

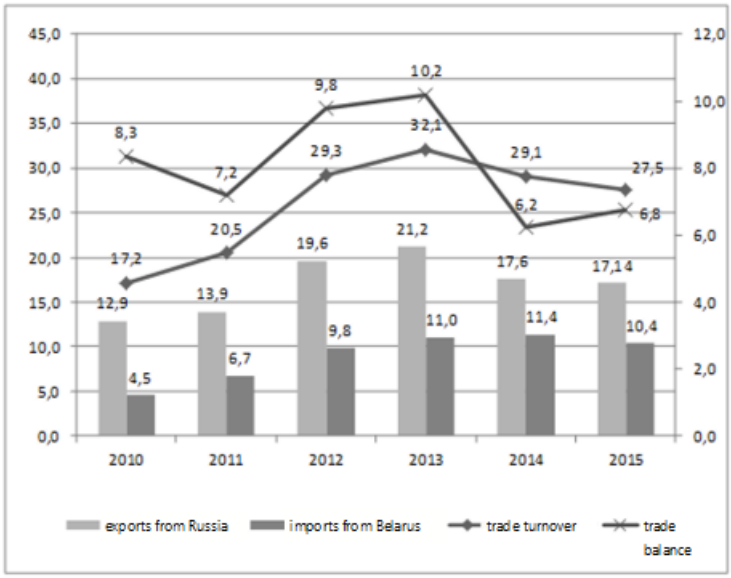

Fig. 2. Russia-Belarus bilateral trade (exports/imports) in 2015 prices (USD billion)

Based on [1; 5].

Russia and Belarus are building a common economic and social space with uniform (and prospectively common) mechanisms for economic regulation based on market principles. However, it is still early to declare uniformity in this respect.

For many years, the Russian-Belarusian integration process has been dominated by an intergovernmental approach, which cannot always guarantee foreign policy cohesion and internal consolidation [11].

It is important to understand that achieving the actual economic and — especially — social cohesion will take a long time despite the declared but doubtful growth in each of the states. Moreover, a significant proportion of unification spending will be accounted for by internal — primarily Russian — sources without any restitution guarantee. At the same time, it is important to identify the level of economic cohesion, which requires outlining the paths of convergence and relevant economic policy regimes. Political efforts create the necessary framework, but they are not decisive in attaining purely economic goals [7, 8, 9].

Recent transition experiences provide new materials for theoretical interpretations of transition economies. An analysis shows that despite the particularities of transition in former socialist republics such processes cannot be considered in isolation from the global development patterns [12]. They have certain universal features: the formation of a modern economic mechanism; increasing internationalisation of economic ties; the need for human factor development, etc. Moreover, there are certain similarities in transition processes across the world.

— The Russian Federation, Belarus, and any other CIS country are facing the need to ensure high economic growth rates to catch up with developed industrial states.

— The central element of transition is institutional changes, which is explained by a relatively high proportion of public property.

— An important benchmark is the development of an economic mechanism based on recognising the equality of all types of ownership.

What policy should be pursued by Russia and Belarus to accelerate convergence and avoid the non-market movements of production factors (capital and labour)? As of today, actual unification mechanisms function very poorly, since

— the current integration policy pegs prices and salaries to national borders;

— the declarations of Union goals do not describe development mechanisms to achieve them, for instance, the economic measures to manage the intra-union migration;

— there are no developed approaches to the unification of tax and currency exchange rules and their impact on economy.

Recognising these facts is crucial, since without a complete understanding of all the problems the governance of the economic and monetary union will be very complicated. Probably, such recognition will result in a policy that does not focus solely on factor movements.

This work is an attempt to answer the above questions and propose possible scenarios of economic integration.

The integration process would be accelerated, if salaries were equalised. Salary equalisation can be identified with eliminating employment and production subsidies. Nevertheless, this plan cannot be implemented without a policy aimed at salary and price flexibility. A solution is salary differentiation, which affects migration rates. However, such initiatives would slow down the exchange of intra-union investment and stall the growth of the already common economy (investment generation in the post-Soviet countries has a very specific feature — a large proportion of cost is accounted for by the non-manufacturing sector in these countries, which is fraught with various risks). Another possible solution is unemployment or unemployment period differentiation. In this case, salary subsidies would become an effective instrument for regulating migration. Any of the above variants would involve financial movement. The only way to avoid such movements is a self-support policy, i. e. equalising costs per labour unit across the common economic space. Even if all areas of the economy are harmonised (except for international productivity, which is extremely difficult to attain), factor movements will still take place. Supposedly, these movements will be of non-market nature.

Note that no large investment is needed to support a regular growth in production; however, it should increase steadily. This very circumstance gave the name to the accelerator principle.

It is important to address the dynamic theory by R. Harrod who proposed a model reflecting the instability of growth. If, over a certain period, investment exceeds level I necessary to maintain growth, future production capaci-

ties will be excessive, unless future investment diverges further from the level determined by the existing rate. Thus, a combined effect of a multiplier and an accelerator leads to instability, which underlies numerous theories of economic fluctuations. The above model describes explosive instability rather than economic fluctuations. In effect, a physical 'divergence' of an economy is impossible, since different forces will work against the accelerator effect.

Models suggesting subsidies to individual factors of production are subject to criticism, since they tacitly change relative factor prices without affecting market prices, i. e. they unbalance the cost/price and investment/savings system. Price and production levels should be compatible — if prices increase dramatically while the amount of monetary resources remains unchanged, the interest rate will follow the change in prices. This situation will ensue reduced interest in investment. Therefore, production can only diminish, for otherwise the established consumption habits will result in excessive savings.

An analysis of the current macroeconomic situation and a relevant forecast for unification should be carried out based on investment flows. However, one could not expect considerable intra-union investment, since there are no incentives to allocate money to the neighbouring country, where growth rates are not much higher than at home. Moreover, any investment would be very sensitive to the current and expected production output and interest rates. Thus the, 'productivity differentiation' factor impedes investment, which can pose a threat to the unification process [15].

One of the key factors affecting a common economy will be the preparation for the rouble adoption in Belarus and the unification of currency exchange rules. It is expected that, at the preparation stage, the exchange rate of the smaller country's currency will plummet. Naturally, financial movement will be inevitable in Belarus. Theoretically, such movements should be financed through the unification of tax systems, since private savings would be insufficient. In other words, capital in the smaller country requires temporary diversification of internal production through the consumption of goods and capital. Consumption deficit can be overcome by imports from the larger country financed by loans from Russia. In this case, income deficit will turn into current deficit. This is not likely to have a profound effect on the exchange rate of the Belarusian rouble. However, when the effect of tax unification reaches its maximum, the internal proportion of permanent income and consumption will return to previous levels and the external proportion (i. e. purely foreign assets and relevant earnings) will account for deficit financing. Since this situation implies a decrease in permanent income caused by a reduction in foreign income, the equilibrium can be restored based on the initial exchange rate only if the marginal propensity to import remains the same. In other words, this will be feasible if imports decrease at the same rate as the foreign income of Belarus does. Unfortunately, the marginal propensity to import is rather low in Belarus. Thus, the country's leadership should either preserve trade deficit or let the Belarusian rouble plummet.

Studies show that a 1.8% increase in the effective interest rate in any CIS country (or a 3% increase during stagnation or depression) results in an average 0.5% increase in that in Russia. On the other hand, the same calculations suggest a possibility of a 15—20% reduction in the competitive ability of the Belarusian economy during 10 years following the unification. The costs to be borne by the CIS partners of the union are also significant (estimated at 27—36% of the total unification costs). Thus, the official forecasts declaring a 5—10 year convergence period appear to be overly optimistic.

Financing the process of economic convergence can and should be based on the assumption about the low absorption capacity of their financial systems. The absorption capacity can be described as the amount of community financial assistance a country can receive without a significant increase in inflation and pressure on the national budget. The absorption capacity criterion has not been used in the Russian-Belarusian economic union so far. However, its introduction is a key element of any cohesion policy.

There are numerous forecasts for the further development of countries with a transit economy and none of them predicts a continuing decline in production. Such forecasts are based on the assumption that economic development will be consistent, whereas external shocks will be avoided. However, one cannot completely exclude the possibility of unfavourable development, even if most post-socialist states have secured an economic growth (although growth rates differ significantly across the CIS).

When developing and analysing the criteria for economic convergence (or divergence) between states, it is important to remember the three major hypotheses explaining the absence of convergence.

The first one suggests that leaders in technology benefit from the production technology — economies of scale make the rich richer. The second argues that convergence exists only in countries with an adequate human capital capable of mastering modern technology. According to the third one, poor countries have a low potential, although they develop more rapidly when the gap between the current income and economic growth potential increases. Any of the above hypotheses — if proved applicable to the Russian-Belarusian economic union — would mean a medium feasibility of economic convergence processes, since economic growth and economic convergence require developed economic institutions. Countries with a closed economy, where rights to property are not safeguarded, are dominated by non-market methods to protect national commodity and financial markets. Their national currencies are either non-convertible or currency conversion is restricted. Such states will demonstrate low convergence rates, regardless of the national level of production and technology and the initial human capital. A primarily declarative integration promotion policy paradoxically impedes convergence within an international region and widens the gap between governments' political efforts and the capacities of national economies.

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